



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9558]

RIN 1545-BJ21

Corporate Reorganizations; Allocation of Basis in “All Cash D” Reorganizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations regarding the determination of the basis of stock or securities in a reorganization where no stock or securities of the issuing corporation is issued and distributed in the transaction. These temporary regulations clarify that, in certain reorganizations where no stock or securities of the issuing corporation is issued and distributed in the transaction, the ability to designate the share of stock of the issuing corporation to which the basis, if any, of the stock or securities surrendered will attach applies only to a shareholder that owns actual shares in the issuing corporation. These temporary regulations affect corporations engaging in such transactions and their shareholders. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective on **INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER**.

Applicability Date: For dates of applicability, see §1.358-2T(d).

FOR FURTHER INFORMATION CONTACT: Lisa A. Fuller at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 19, 2006, the IRS and the Treasury Department published a notice of proposed rulemaking (REG-125632-06) in the **Federal Register** (71 FR 75898) that included regulations under section 368 (the Temporary Regulations). These regulations provided guidance regarding whether the distribution requirement under sections 368(a)(1)(D) and 354(b)(1)(B) is satisfied if there is no actual distribution of stock or securities. On December 18, 2009, the IRS and the Treasury Department published final regulations (TD 9475) in the **Federal Register** (71 FR 75879) that, in addition to providing guidance regarding the qualification of certain transactions as reorganizations described in section 368(a)(1)(D), amended the regulations under §1.358-2(a)(2)(iii) to provide that in the case of a reorganization in which the property received consists solely of non-qualifying property equal to the value of the assets transferred (as well as a nominal share described in the final regulations), the shareholder or security holder may designate the share of stock of the issuing corporation to which the basis, if any, of the stock or securities surrendered will attach. The IRS and the Treasury Department issued these regulations in

response to comments that, in a transaction where the consideration received consists solely of cash and a nominal share, the mechanics of preserving basis, if any, in the shares of the stock or securities surrendered in the basis of the stock of the issuing corporation were unclear under current law.

The IRS and the Treasury Department have become aware that some maintain these rules, as written, could be interpreted to allow an inappropriate allocation of basis by persons that do not own actual shares of stock in the issuing corporation. This interpretation would most likely be asserted in the context of a lower-tier reorganization transaction involving corporations in two different ownership chains that have the same ultimate indirect shareholder(s). Specifically, the argument is that the rules could be interpreted to allow persons who do not own actual shares of stock of the issuing corporation to allocate the adjusted basis of the nominal share to an actual share of stock of the issuing corporation directly owned by someone else before the nominal share is deemed to be further transferred through the chains of ownership to reflect the actual ownership of the target and issuing corporations. Under this interpretation of the rules, the actual share to which the basis was allocated could then be sold to recognize a loss, and taxpayers would avoid losing the nominal share's basis, which would otherwise be zero following its deemed transfer through the chains of ownership to the actual shareholder of the issuing corporation.

For example, assume that J owns all the stock of corporations X and Y, and X owns all of the stock of corporation T. X has a \$150 basis in the T stock. The corporations do not join in the filing of a consolidated return. T sells all of its

assets to Y for \$100 cash, their fair market value, and liquidates. Pursuant to §1.368-2(l), Y will be deemed to issue a nominal share of Y stock to T in addition to the \$100 actually exchanged for the T assets, and T will be deemed to distribute the nominal share of Y stock to X. X will have a basis of \$50 in the nominal share of Y stock under section 358(a). Pursuant to §1.368-2(l), the nominal share of Y stock is deemed to be further transferred to J in order to reflect the actual ownership of Y. J's basis in the nominal share of Y stock would be zero under section 301(d). However, some argue that the rule, as currently written, could be interpreted as allowing X to allocate the \$50 of basis in the nominal share to an actual share of Y stock owned by J prior to the nominal share of Y stock being deemed to be further distributed to J.

The IRS and the Treasury Department did not intend for the final regulations to allow such an inappropriate allocation of basis and do not believe the current regulations support such an allocation. Accordingly, the IRS and the Treasury Department are proposing rules in the Proposed Rules section in this issue of the **Federal Register**, to clarify that, in certain reorganizations where no stock or securities of the issuing corporation is issued and distributed in the transaction, the ability to designate the share of stock of the issuing corporation to which the basis, if any, of the stock or securities surrendered will attach applies only to a shareholder that owns actual shares in the issuing corporation.

Explanation of Provisions

The preamble to the final regulation noted that the IRS and the Treasury Department believe the ability to designate any remaining basis is consistent with

current law regarding basis determination, as a similar result would occur under §1.358-2 if an amount of issuing corporation stock was actually issued in the transaction (74 FR 67053; 74 FR 67056; TD 9475). To complete the analogy, however, in the case where stock is actually issued in a lower-tier transfer, such stock would then be transferred through chains of ownership, and in the process, if basis in the stock exceeded value, the basis in the shares would be reduced to the fair market value of the shares in the hands of the distributee, under section 301(d). Accordingly, in such a case, basis in excess of the value of the issuing corporation shares would generally be preserved only where the shareholder of the transferor corporation does not further distribute the stock of the issuing corporation in a transaction to which section 301 applies.

Consistent with this view, these temporary regulations clarify and amend the final regulations (TD 9475) under §1.358-2(a)(2)(iii) by providing that if an actual shareholder of the issuing corporation is deemed to receive a nominal share of stock of the issuing corporation described in §1.368-2(l), such shareholder must, after allocating and adjusting the basis of the nominal share in accordance with the rules of this section and §1.358-1, and after adjusting the basis in the nominal share for any transfers described in §1.358-1, designate the share of stock of the issuing corporation to which the basis, if any, of the nominal share will attach.

The IRS and the Treasury Department also are clarifying the effective date for a 2009 amendment to the regulations under §1.358-2(a)(iii).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Lisa A. Fuller of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.358-2 also issued under 26 U.S.C. 358(b)(1).

Par. 2. Section 1.358-2 is amended by:

1. Revising paragraph (a)(2)(iii).
2. Revising paragraph (d).

The revisions read as follows:

§1.358-2 Allocation of basis among nonrecognition property.

(a) * * *

(2) * * *

(iii) [Reserved]. For further guidance, see §1.358-2T(a)(2)(iii).

* * * * *

(d) Effective/applicability date. This section generally applies to exchanges and distributions of stock and securities occurring on or after January 23, 2006. However, paragraph (a)(2)(iii) of this section applies to exchanges and distributions of stock and securities occurring on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. See §1.358-2(a)(2)(iii), as contained in 26 CFR part 1 revised as of April 1, 2010, for exchanges and distributions of stock and securities occurring on or after January 23, 2006, and before **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Par. 3. Section 1.358-2T is added to read as follows:

§1.358-2T Allocation of basis among nonrecognition property (temporary).

(a)(1) through (a)(2)(ii) [Reserved]. For further guidance, see §1.358-2(a)(1) through (a)(2)(ii).

(iii) For purposes of this section, if a shareholder or security holder surrenders a share of stock or a security in a transaction under the terms of section 354 (or so much of section 356 as relates to section 354) in which such shareholder or security holder receives no property or property (including property permitted by section 354 to be received without the recognition of gain or “other property” or money) with a fair market value less than that of the stock or securities surrendered in the transaction, such shareholder or security holder shall be treated as follows.

(A) First, the shareholder or security holder shall be treated as receiving the stock, securities, other property, and money actually received by the shareholder or security holder in the transaction and an amount of stock of the issuing corporation (as defined in §1.368–1(b)) that has a value equal to the excess of the value of the stock or securities the shareholder or security holder surrendered in the transaction over the value of the stock, securities, other property, and money the shareholder or security holder actually received in the transaction. If the shareholder owns only one class of stock of the issuing corporation the receipt of which would be consistent with the economic rights associated with each class of stock of the issuing corporation, the stock deemed received by the shareholder pursuant to the previous sentence shall be stock of such class. If the shareholder owns multiple classes of stock of the issuing corporation the receipt of which would be consistent with the economic rights associated with each class of stock of the issuing corporation, the stock deemed received by the shareholder shall be stock of each such class owned by the

shareholder immediately prior to the transaction, in proportion to the value of the stock of each such class owned by the shareholder immediately prior to the transaction. The basis of each share of stock or security deemed received and actually received shall be determined under the rules of this section.

(B) Second, the shareholder or security holder shall then be treated as surrendering all of its shares of stock and securities in the issuing corporation, including those shares of stock or securities held immediately prior to the transaction, those shares of stock or securities actually received in the transaction, and those shares of stock deemed received pursuant to the previous sentence, in a reorganization under section 368(a)(1)(E) in exchange for the shares of stock and securities of the issuing corporation that the shareholder or security holder actually holds immediately after the transaction. The basis of each share of stock and security deemed received in the reorganization under section 368(a)(1)(E) shall be determined under the rules of this section.

(C) If an actual shareholder of the issuing corporation is deemed to receive a nominal share of stock of the issuing corporation described in §1.368-2(l), such shareholder must, after allocating and adjusting the basis of the nominal share in accordance with the rules of this section and §1.358-1, and after adjusting the basis in the nominal share for any transfers described in §1.368-2(l), designate the share of stock of the issuing corporation to which the basis, if any, of the nominal share will attach.

(a)(2)(iv) through (c), Example 14 [Reserved]. For further guidance, see §1.358-2(a)(2)(iv) through (c), Example 14.

Example 15. (i) Facts. Each of Corporation X and Corporation Y has a single class of stock outstanding, all of which is owned by J, an individual. J acquired 100 shares of Corporation X stock on Date 1 for \$1.50 each. On Date 2, Corporation Y acquires the assets of Corporation X for \$100 of cash, their fair market value, in a transaction described in §1.368-2(l). Pursuant to the terms of the exchange, Corporation X does not receive any Corporation Y stock. Corporation X distributes the \$100 of cash to J in liquidation. Pursuant to §1.368-2(l), Corporation Y will be deemed to issue a nominal share of Corporation Y stock to Corporation X in addition to the \$100 of cash actually exchanged for the Corporation X assets, and Corporation X will be deemed to distribute all of the consideration to J. J will have a basis of \$50 in the nominal share of Corporation Y stock under section 358(a).

(ii) Analysis. Under paragraph (a)(2)(iii) of this section, J is the actual shareholder of Corporation Y, the issuing corporation, deemed to receive the nominal share of Corporation Y stock described in §1.368-2(l). Therefore, J must designate any share of Corporation Y stock to which the basis of \$50 in the nominal share of Corporation Y stock will attach.

Example 16. (i) Facts. Each of Corporation X and Corporation Y has a single class of stock outstanding, all of which is owned by Corporation P. Corporation T has a single class of stock outstanding, all of which is owned by Corporation X. The corporations do not join in the filing of a consolidated return. Corporation X acquired 100 shares of Corporation T stock on Date 1 for \$1.50 each. On Date 2, Corporation Y acquires the assets of Corporation T for \$100 of cash, their fair market value, in a transaction described in §1.368-2(l). Pursuant to the terms of the exchange, Corporation T does not receive any Corporation Y stock. Corporation T distributes the \$100 of cash to Corporation X in liquidation. Pursuant to § 1.368-2(l), Corporation Y will be deemed to issue a nominal share of Corporation Y stock to Corporation T in addition to the \$100 of cash actually exchanged for the Corporation T assets, and Corporation T will be deemed to distribute all of the consideration to Corporation X. Corporation X will have a basis of \$50 in the nominal share of Corporation Y stock under section 358(a). Corporation X will be deemed to distribute the nominal share of Corporation Y stock to Corporation P. Corporation X does not recognize the loss on the deemed distribution of the nominal share to Corporation P under section 311(a). Corporation P's basis in the nominal share is zero, its fair market value, under section 301(d).

(ii) Analysis. Corporation X is deemed to receive the nominal share of Corporation Y stock described in §1.368-2(l). However, under paragraph (a)(2)(iii) of this section, Corporation X is not an actual shareholder of Corporation Y, the issuing corporation. Therefore, Corporation X cannot designate any share of Corporation Y stock to which the basis, if any, of the nominal share of Corporation Y stock will attach. Furthermore, Corporation P cannot designate a share of Corporation Y stock to which basis will attach because Corporation P receives the nominal share with a basis of zero.

(d) Effective/applicability date. This section applies to exchanges and distributions of stock and securities occurring on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

(e) Expiration date. This section expires on or before November 18, 2014.

Steven T. Miller
Deputy Commissioner for Services and Enforcement.

Approved: November 1, 2011

Emily S. McMahon
Acting Assistant Secretary of the Treasury (Tax Policy).

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